Washington State Department of
Financial Institutions

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REVERSE MORTGAGES FACT SHEET

What is a Reverse Mortgage?

A reverse mortgage is a financial transaction between a consumer and a lender where the consumer uses home equity to secure cash while remaining in his or her home. The difference between a reverse mortgage and the more traditional mortgage is that the consumer already owns a home - or proceeds from the sale of the home - and the lender pays the consumer each month, rather than the home owner making payments. The home is the "value" used to secure a loan.

A reverse mortgage may be a tool that works for some homeowners and not for others. You decide if it fits your needs. You don't have to buy a reverse mortgage or any other type of mortgage. You are allowed to shop around as much as you like.

In considering a reverse mortgage you should use careful and detailed investigations to see if it meets your long-term goals and needs. Insist on full disclosure of costs, your liability, assumed annual appreciation rates, and the assumed loan period. Make sure anyone offering a reverse mortgage carefully explains these terms and helps you understand them.

How a reverse mortgage typically works

A homeowner, usually a senior citizen, has paid or nearly paid for their home. The homeowner wants to live in the home for the rest of his or her life and does not plan to pass it on to an heir. The homeowner wants to receive some value for the home, yet remain in the home.

The lender agrees to pay the homeowner for the home in two steps, first with a loan against the value of the home, and second with an agreement to collect only the proceeds of the sale of the home at the end of the contract period.

The homeowner is trying to secure a place to live and receive funds, usually for living expenses, vacations, health care, etc. If he or she passes away before the end of the contract period the lending institution will get repaid from proceeds from the sale of the home. If the homeowner lives longer than the period of the contract he or she may have to sell their house to pay off the reverse mortgage.

Reverse mortgages are most often rising-debt loans. The interest on the loan is added to the principal loan balance each month. This is done because the interest is not paid on a current basis. This makes interest increase over the time of the loan as the interest compounds.

Reverse mortgages generally come with fees. Origination fees and closing costs are added to the amount of the loan. There is also often an insurance fee.

The lending institution is trying to make money by selling the homeowner money. The repayment will come largely from the sale of the house after the homeowner has passed away or after the contract period.

The homeowner must gage the length of the contract period and the length of time he or she expects or wants to remain in the home. If the homeowner lives longer than he or she expects they may find themselves in a situation where they have to leave the home as it is being sold to pay off the reverse mortgage.

Disclosures

In reverse mortgages, the lender must provide a series of disclosures to the borrower. These are federally required pieces of information about the potential loan. They should tell the potential buyer of the mortgage what their financial liability will be. In most cases this is limited to the proceeds from the sale of their home. The consumer could negotiate to save some of the value they have in their home so they get something when the home is sold.